crucial. First, whatever their number, Waterman assumes that all coalitions of either program services or cable systems are of equal size. Second, he assumes that all coalitions of cable systems are myopic, in that each considers "only the relatively marginal impact of its [behavior] on the supply of differentiated products which can be made available by upstream firms."[31]

Using these assumptions, Waterman finds that "the actions of a price making retailer coalition with a very small national market share will have a negligible effect on product variety" and also that when there is "a national retailer coalition," i.e., when all cable systems are under common ownership, "the externality problem of local myopic behavior ... disappears .... A national retailer coalition which engages in price making behavior results in an equilibrium which maximizes joint industry profits."[32] In other words, at the extremes in which each cable system has a small and vanishing share of all subscribers, or there is a single MSO nationwide, the adverse effects of ownership structure on the supply of programs are not present.

The intermediate case in which there are a number of myopic MSOs is the one that concerns Waterman because, in his model, myopia translates into a reduced supply of programming as each MSO attempts to "free ride" on the expenditures of others.

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[31] "Local Monopsony and 'Free Riders' in Information Industries," at 18.

[32] Id. at 18.

That is, each myopic MSO attempts to pay only the additional costs of distributing a program service to it, and contributes nothing to the fixed costs of program production. Waterman concludes that "if price making behavior were successfully practiced by all of many local monopoly retailer coalitions, the cumulative effects of myopic behavior could essentially prevent the industry from functioning,"[33] because the attempt of each coalition to "free ride" could make it impossible for program suppliers to cover their costs.

Of course, the cable industry does function, despite the results of the Waterman model. How can this be so? The answer can be found by questioning, and rejecting, Waterman's assumption that cable MSOs are myopic. As Waterman recognizes elsewhere in his paper, a large MSO will take into account the effects of its own actions on the supply of programming available to it.[34] Even if other MSOs ignored the effects of their behavior, thus threatening the functioning of the industry, a large MSO would not do so. Indeed, an implication of Waterman's analysis is that unless cable system ownership is highly fragmented, the presence of large operators may result in more programming, because otherwise the adverse effects of myopia on program supply will predominate.

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[33] Id.

[34] See Waterman op. cit. at 25. See Besen Report at 20-22 for a related analysis.

TCI assumes that Waterman is not recommending the dissolution of all MSOs. In fact, he should welcome the existence of large MSOs, since their behavior serves to mitigate the effect of myopia that would exist if all MSOs were small enough to attempt to free ride. Indeed, Waterman appears to recognize this point in his paper when he writes that "even collusive behavior ... can be beneficial to consumers by limiting opportunistic price setting behavior by individual retail firms with monopsony power."[35] In contrast, Waterman's letter to the Commission conveys the misleading impression that his analysis suggests that existing MSOs are too large. However, his paper can more plausibly be read to support the conclusion that the presence of large MSOs is required for efficient functioning of the cable industry. Moreover, Waterman provides no support for his proposed ownership limit. Instead, he merely asserts that ownership combinations could adversely affect programming even at limits lower than the 25-30 percent suggested in the Notice.

The same deficiency permeates Waterman's proposal for strict channel occupancy limitations: He provides no empirical evidence but, rather, simply jumps from his theoretical model to his arbitrary conclusion.

TCI submits that, in the absence of strong, empirical evidence to the contrary, the Commission should not reject the standards developed through the years in the extensive economic literature and antitrust case law dealing with vertical

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[35] Id. at 25.

foreclosure. That learning would permit vertical foreclosure of 50 percent or more of a relevant market before treating the foreclosure as substantially anticompetitive. Indeed, it could be argued that the actual foreclosure in the case of, for example, a limitation of 50 percent on MSO affiliated channels, would be less harmful than the foreclosure in the typical exclusive dealing case. In such a case, 100 percent of the purchaser's requirements are foreclosed to others. In the MSO example, 50 percent of each MSO's capacity would still be open to competition. This is analogous to a partial requirements contract, a type of contract that has almost always been approved under the antitrust laws. See I Antitrust Developments (Third) 176 (1992). Moreover, since programming is sold in a national market, it makes no difference that in some local markets the foreclosure may be as much as 50 percent. Only if every cable operator in the nation carried affiliated programming accounting for 50 percent of its channels would the overall foreclosure approach the 50 percent of a relevant market (the national programming market) that constitutes the threshold in the antitrust cases. While TCI is not here suggesting a 50 percent limitation, the above analysis suggests that any channel occupancy limits eventually adopted should be very liberal indeed.

4) Consumer Federation of America ("CFA") -- Replying to the scattershot comments of the CFA is not an easy task, because its views on market structure possess little coherence,

except possibly in revealing a consistent hostility to any but the smallest firms. Thus, the CFA tells the Commission that "cable operators who control access to large numbers of viewers can extract concessions from programmers who need to reach a large audience"[36] and, simultaneously, that "powerful programmers can extract concessions from large cable operators, who rely on these programs to attract viewers, by manipulating prices and program availability."[37]

Although the CFA suggests that a market structure in which there are both large cable operators and powerful programmers might operate in the public interest, it concludes that "the shared interest of cable operators ... and programmers ... has inflated cable rates."[38] But CFA's comments provide absolutely no indication of how joint ownership of cable systems, or vertical integration between cable operators and program services, lead to higher subscriber rates.

The CFA claims that "[t]he pattern of joint ownership [of cable systems] has dramatically increased the concentration in the industry measured by the four and eight firm concentration ratios."[39] However, CFA's own data actually show that concentration in cable system ownership, as measured by the four

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[36] Comments of CFA at 28-29.

[37] Id. at 29.

[38] Id. at 30.

[39] Id. at 32-33.

and eight firm concentration ratios, did not change between 1973 and 1988, the latest year for which it reports data.

The closest that the CFA comes to an intelligible theory is in its suggestion that "the cable industry rapidly became dominated by a small oligopoly of interconnected vertically integrated firms."[40] The resulting power is then used, according to the CFA, to extract "exclusive or favorable distribution terms," presumably from independent networks. Apparently the result is to disadvantage potential overbuilders, or rival distributors using HSDs or other technologies. But if, as the CFA claims, there are independent networks that must provide programming to cable operators on favorable terms, why do not these networks join together with the disadvantaged distributors to exploit mutually profitable opportunities? The CFA does not say.

Finally, CFA fails completely to appreciate the efficiencies that result from vertical integration. TCI has previously explained in detail the sources of these benefits, but one in particular is worth emphasizing here. Waterman in his paper notes that "vertical integration...can be beneficial to consumers by limiting opportunistic input price setting behavior by individual retail firms with monopsony power." Because cable MSOs may have incentives to attempt to "free ride" on programming largely paid for by others, Waterman notes that "in this model,

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[40] Id. at 31.

"vertical integration ... can only increase variety."[41] Just what the CFA's views are on the connection between vertical integration and the programming that is available to viewers cannot be divined from its comments.

The CFA would apparently prefer a world in which a very large number of independently-owned cable operators obtain programs from firms with no other media interests each of which operates a single network. But such an approach would necessarily sacrifice the economies of scale from joint cable system ownership and the efficiencies of vertical integration without providing any associated benefits. If the CFA is to be taken seriously, it must do better than simply intone the mantra that "big is bad."

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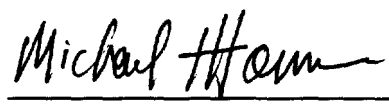
[41] Waterman, op. cit. at 25.

V. CONCLUSION

For the foregoing reasons, TCI respectfully recommends that the Commission adopt rules to implement Section 11 of the Act consistent with the comments contained herein and in its initial comments in this proceeding.

Respectfully submitted,

TELE-COMMUNICATIONS, INC.



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